Episode 4:

Restricted Return InVIT

About the episode

What's been missing in India's InvIT landscape? A product that acts as a true bond proxy, some might say. Well, SEBI's proposed Restricted Return InvITs delivers just that.

This new product offers risk-averse investors a safe, fixed return, with the downside protected and the upside capped. But it's not just for investors- sponsors stand to gain too. Any returns beyond the promised payout go straight to them, and if returns dip below expectations, sponsors will have to step in to cover the shortfall.

In this episode of Resolüt Audio, host Payaswini Upadhyay speaks to Ruchir Sinha to examine the proposals, explore how sponsor-investor agreements could evolve and who the target investors are for this product.

Transcript

Payaswini: SEBI is calling it a Restricted Return InvIT where the return to unitholders is managed and restricted to certain thresholds. The intent is to protect the downside and cap the upside for investors. Commercially speaking, what will it allow sponsors to do?

Ruchir: Very essentially, to put it in layman terms, a sponsor through an InvIT can give a deal to a large institutional investor to say I need your capital for this private listed InvIT, which will deploy that capital in under-construction assets as well.

The deal that I'm offering you is that I'll offer you a certain return, I'll offer you a certain dividend expectation. If I don't meet that dividend expectation, I will meet it through my own funds. But if I exceed your dividend expectations, then the upside is not for you to take, it's for me. So, I'm protecting your downside, but I'm also capping your upside.

To come up with such an innovative regime, I think we must thank SEBI. It's a smart move to capture the minds of FIGs or Fixed Income Group investors who are looking for some degree of downside protections and who don't care too much about the equity upside. I think the product will suit them a lot.

Payaswini: Let me call out some key numbers in SEBI's consultation paper- they've proposed it as a privately placed InvIT with a minimum asset value of Rs. 50,000 crores, and minimum investment lot of Rs 500 crore. SEBI has also proposed a credit rating requirement for the sponsor to ensure it's able to pay the investor if the downside protection gets eroded. What challenges in the sponsor-investor relationship exist today that this product could potentially solve for?

Ruchir: In the existing regime, you have the optionality to issue subservient or junior units to the sponsor. But under this proposed regime there is also the ability for the sponsor to become senior because of the equity upside. Beyond a certain limit, it will go to the account of the sponsor. So I think a new regime or a new framework was indeed required - probably as a new chapter in the existing InvIT regulations - to allow for some of these sponsor- investor commercial arrangements to happen.

For instance, the sponsor may either put the money back into the InvIT which is then distributed in case of a shortfall, or the sponsor may directly compensate the investor. Some of those things are not yet clear (in the consultation paper). But I believe, the new framework will address some of these challenges. The bottom line really being that some of the sponsor-investor relationships, which were pretty much well-known, can now be formally documented without the challenge of - oh can I do this or can I not do it.

Payaswini: Okay, final question then. What kind of investors will be interested in the product? And will truly bespoke agreements become possible?

Ruchir: Okay, so all the Canadian Tier I funds are here (in Indian InvITs), the sovereign wealth funds are also here. I think we still need more capital from some of these players and maybe the Tier II guys also. Now for some of our under-construction assets and for those large, big-ticket millions and billions to come in, I think one aspect has become clear over some time is that some of these investors prefer SEBI-regulated vehicles and InvITs for their own tax optimization. And the light touch regulations by SEBI have been the favorite for investors for investing into Indian infrastructure.

So, I think that's truly something that investors wanted. But the other challenge that they were also facing is to some extent a degree of over-regulation at certain places. For instance, investors cannot have inter-se rights amongst themselves since the current InvIT framework says that all unit holders must have the same rights. Investors were not very comfortable with some of those restrictions. And I believe that this new (proposed) InvIT regime will allow for bespoke commercial arrangements which are more laissez faire, so to speak.

Whatever arrangements investors want, I think can possibly be done with the sponsor. The question is, will SEBI also allow for multiple set of units to be issued to different investors such that more bespoke structures can be created vis-à-vis each investor depending on the capital that they are putting in. I'm hoping there should be flexibility even for exercising certain inter-se rights like veto rights and deployment rights etc. So, the sponsor can be kept in check and those rights may be available to some of the larger investors; may not be able to some of the smaller investors.

And I believe if that commercial approach is settled, I think some of these InvITs can again be quite attractive, particularly to the large annuity investors or investors investing with a social license who want to come and invest in India but are not looking at a very significant equity upside. Obviously, a downside protection is one of the key aspects for them.

Payaswini: The product is clearly targeted towards sophisticated investors who would want rights commensurate with their investments. I guess the success of this product will depend on the flexibility SEBI allows in the sponsor-investor relationship. We'll of course get you the update once Restricted Return InvIT provisions take the final shape. Thanks for tuning in.